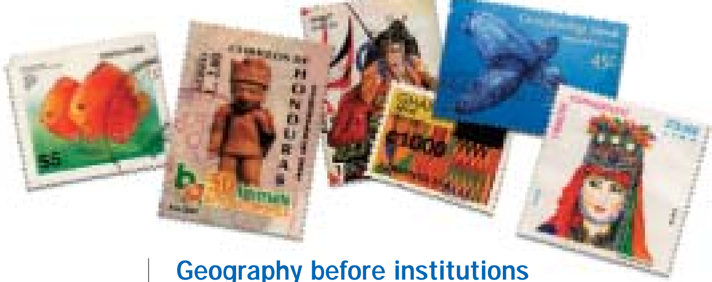
LETTERS

TO THE EDITOR



Welfare state not a burden

Two points in your article on Professor Allan Meltzer are rather perplexing (June 2003). First, I am not sure that Europe's alleged free riding on the back of U.S. security explains all present frictions. "The force that drove the alliance together," to which Meltzer refers, was made up of a combination of the integrity, credibility, and moral prestige attributed to the United States by its European allies. But American positions of late have been disappointing. Slogans like "A first war over weapons proliferation" (Meltzer again) are seen in Europe, perhaps abusively, as cooked-up tales to cover Halliburton's business and other oil interests. The absence of international solidarity in matters like environmental policy and human rights courts and Enron-like stories in which top corporate circles and the present administration have allegedly been involved have done much to erode the picture of a U.S. model of a society to be copied by the rest of the world. Hence the distrust in the American alliance and reluctance to adhere to U.S. leadership.

The second point concerns Meltzer's reference to the "burden" of the welfare state. In European eyes, a terrible burden borne by the whole nation would be the absence of a welfare system. Take, for instance, the waste of intellectual and human resources that will result from present U.S. tax cuts with a bearing on welfare and financing of educational facilities. A still more glaring example of the importance of a welfare system underlies Oregon governor Ted Kulongoski's declaration: "Of all the challenges we face, none is more troubling than the fact that thousands of Oregonians—many of them children—don't have enough to eat."

A welfare state has a cost indeed, probably in terms of forgone growth, but solidarity and compassion are also values that count at least as much as growth and wealth in private hands.

Jose Ripoll
Geneva, Switzerland

Disbursing aid wisely

Bulir and Lane's stimulating piece, "Managing the Fiscal Impact of Aid" (December 2002), provides near-comprehensive coverage of the principal issues. The only omission is the lack of recognition given to the low absorptive capacity of a number (the majority?) of countries as being an important factor in the significant difference between the financial commitments made by development partners and the funds eventually disbursed and spent. It would be foolhardy for the former to disburse funds that they knew would not (and could not) be spent over a given period. Both development partners and recipient governments need to continue to allocate resources for developing the capacity of those charged with aid administration (and project/program planning) if this critical bottleneck is ever to be overcome. The payoff could be immense.

Martin Fowler
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Geography before institutions

This relates to the two articles by Daron Acemoglu and Dani Rodrik and Arvind Subramanian on the primacy of institutions for development (June 2003). One of the greatest weaknesses of the studies on the relative primacy of institutions and geography in development is the treatment of regions as geographically or institutionally exclusive categories. There is a need to look at situations where different geographical and institutional characteristics exist simultaneously within a given country or region.

In Manipur, a province in northeast India, there is a clear division of topography into hills and valleys, with the two having quite different property rights regimes. The colonialists introduced a modern property rights regime and established a framework for the rule of law in situations where the marginal cost (as determined by geographical factors) was lower than the marginal benefit. The traditional community or chieftain ownership system of land still prevails in the hill areas, where the marginal cost of establishing modern property rights and the rule of law—the cost being determined by geography—is prohibitively high. In other words, geographical factors determine the nature of institutions. The introduction of modern institutions can be thought of only *after* the initial geographic hurdles are overcome. In topographically inconvenient places, the very high marginal cost of production and transaction costs would confine people mainly to subsistence production.

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Getting inflation targeting right

Finance & Development is a very useful resource for the students in my economic development course. Now for a bit of history-of-economic-thought nit-picking. In "The Move to Inflation Targeting" (June 2003), the author suggests a short-run neutrality of money with which, perhaps, Ricardo would have been comfortable but which is contrary to the analysis of Fisher and Wicksell, inter alios, in the neoclassical *and* classical schools (for example, Henry Thornton), and any modern, mainstream monetary theorist. Furthermore, what's this notion of the interest rate as the price of money? Again, this treatment sets spinning the authors of virtually every principles textbook and, of course, Fisher and Wicksell, who correctly identified the price of money as the reciprocal of the price level. Ironic, these errors about money in an issue featuring Allan Meltzer.

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P.S. Fisher's most important scholarship was in the *twentieth* century; among a multitude of accomplishments, he gave the definitive presentation of the quantity equation of exchange—he did not originate the equation.